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ARTICLES

SUSPENSION AND REMOVAL OF BANK OFFICIALS UNDER THE FINANCIAL INSTITUTIONS REFORM RECOVERY AND ENFORCEMENT ACT OF 1989 ("FIRREA")

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In 1966 Congress enacted the Financial Institutions Supervisory Act of 1966 ("FISA"). Among FISA's provisions was subsection 8(e) to the Federal Deposit Insurance Act, 12 U.S.C. § 1818(e).[1] This subsection granted sweeping powers to "authorized" federal banking agencies[2] to suspend and remove bank officials, in order to protect the interests of the federally insured depository banking system. In the wake of the savings & loan disaster, these powers were significantly fortified and expanded upon by the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).[3] The officials subject to suspension and removal under FIRREA include not only directors and officers, but also such third-parties as controlling stockholders, consultants, lawyers, and accountants.[4] In addition, these enforcement powers may be exercised without reliance upon judicial proceedings in an Article III court, although judicial appeals are available.

To effect removal of a bank official, an agency must make three determinations which are referred to in this article as "improper conduct," "negative consequences," and "scienter." The statute prescribes the requirements of each of these determinations, which are to be considered by the agencies' own administrative law judges (ALJ's).

FIRREA provides that once an official is removed from his position he is automatically subject to a total ban from the insured depository industry. This ban permanently prohibits the official from participation in any federally insured depository institution. Agencies need not await the outcome of the administrative procedure to effect this blanket ban. FIRREA grants the agencies authority, upon making certain preliminary determinations (without an agency hearing), to suspend

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1. This subsection had its genesis in section 30 of the Banking Act of 1933, 12 U.S.C. § 77 (1966. Section 30 provided for the removal of Bank officers and directors by the Federal Reserve Board. However, after its enactment, section 30 fell quickly into desuetude. *See* S. Rep. No. 1482, 89th Cong. 1st Sess. *reprinted in* 1966 U.S.C.C.A.N. (hereinafter "FISA report") 3532, 3540.

2. The authorized banking agencies are now the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision. 12 U.S.C. § 1813(q) (1989).

3. Federal Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, 103 Stat. 183 (Aug. 9 1989).

4. 12 U.S.C. § 1813(u) (1989).

officials immediately from all participation in the insured depository industry pending the outcome of the agencies' removal procedure.[5]

During the past decade the federal courts have attempted, sporadically, to define the limits of the authority granted by FISA. Unfortunately, there have been relatively few reported cases and several important issues remain unresolved. In addition, there has been only one reported case involving suspension or removal of directors or officers since FIRREA was enacted.[6] As a result, there is undoubtedly a great deal of uncertainty in the banking industry regarding the type of conduct that will trigger FIRREA's severe suspension or removal sanctions.[7] The issues surrounding suspension and removal of banking officials are of no small consequence to members of the banking industry. The sudden, forced removal of key personnel from participation in a financial institution impacts heavily upon the financial interests and reputation of both the removed official and the subject institution.[8]

The goals of this article are to summarize the recent developments concerning the agencies' authority to suspend and remove officials under FISA, as modified by FIRREA, and to identify and analyze the outstanding issues generated by the grant of these extraordinary powers under these two Acts. It is hoped that this effort will aid bank officials and government agencies in understanding the limits of their legal duties and authority in this area.

I. SUSPENSION OR REMOVAL OF OFFICIALS

Under the detailed statutory scheme of 12 U.S.C. § 1818(e), removal of an official must follow a prescribed course. However, the threshold issue in any removal action is whether the targeted official is a person subject to this enforcement provision. To define those officials subject to 12 U.S.C. § 1818(e), FIRREA introduced the term "institution-affiliated party."[9] The enactment of this new definition effected a broad expansion of the classes of individuals subject to suspension and removal, as such individuals were formerly limited to: "officer[s] or director[s] of an insured institution."[10] Perhaps the most notable effect of the new FIRREA definition is the inclusion of certain classes of individuals who are not employees of the institutions. These new potential targets include shareholders, consultants, joint venturers, and, under certain circumstances, independent contractors such as attorneys, appraisers, or accountants.[11] Indeed, FIRREA's reach appears to extend to any significant participant in the affairs of the institution. However, this new statutory language did not alone resolve an

5. 12 U.S.C. § 1818(e)(3) (1989).

6. *See* Greenberg v. Comptroller of the Currency, 938 F.2d 8 (2nd Cir. 1991).

7. The court in *Greenberg* did not discuss in any detail the allegations against the directors involved in that case.

8. *See* FISA report, *supra note 1*, at 3539. The report sagely observed the following:

> [the power to suspend or remove an officer or director of a bank or savings and loan association] is an extraordinary power, which can do great harm to the individual affected and to his institution and to the financial system as a whole. It must be strictly limited and carefully guarded.

Id.

9. 12 U.S.C. § 1813(u) (1989).

10. (former) 12 U.S.C. § 1818(e)(1) (1982).

11. 12 U.S.C. § 1813(u)(3) & (4) (1989).

issue which had been the subject of two reported pre-FIRREA cases: Is an agency authorized to "remove" an official who previously resigned his position? Resolution of this issue is critically important to both the agencies and bank officials. If former officials are not subject to removal, targeted officials may avoid the blanket industry bans and the stiff criminal sanctions provided for them under 12 U.S.C. § 1818(j) (1989)[12] by effecting a timely resignation.

The first reported challenge to an agency's authority to remove a former official under FISA was in *Somerfield v. Federal Deposit Insurance Corporation.*[13] In that case, Somerfield filed for a declaratory judgment and injunctive relief in opposition to a notice of removal served upon him by the FDIC pursuant to 12 U.S.C. § 1818(e).[14] Somerfield had been Chairman of the Board of Directors and Chief Executive Officer of Peoples Bank and Trust Company, Wartburg, Tennessee.[15] The notice of removal was served on November 2, 1984. However, Somerfield claimed that he had resigned his position on November 1, the day before receiving the notice.[16]

In response to Somerfield's challenge, the FDIC successfully asserted that the truth of Somerfield's resignation claim was an outstanding issue of fact to be determined at the agency level.[17] Accordingly, in reviewing Somerfield's request for relief the district court did not reach the issue of whether 12 U.S.C. § 1818(e) applied to former directors. Instead, the court denied Somerfield's petition and remanded the case to the FDIC for further fact-finding on the resignation issue.[18]

In refusing to resolve the "former director" issue prior to the FDIC hearing, the district court properly gave deference to the fact-finding function of the FDIC. Certainly the date of resignation was a material fact which the court needed to rule on Somerfield's challenge. If Somerfield was still involved in bank operations on November 2, any ruling on the "former director" issue would have been superfluous. However, the *Somerfield* decision left the banking industry and the agencies without guidance on the "former director" question.

Four years after *Somerfield*, the Circuit Court for the District of Columbia faced a challenge to a final order removing a bank officer who had undoubtedly resigned prior to receiving his notice of removal. In that case, *Stoddard v. Board of Governors of the Federal Reserve System*[19] the Comptroller of the Currency initiated a removal procedure some 10 months after Stoddard had resigned from his positions as Chairman of the Board and Chief Executive Officer of the Michigan National Corporation.[20] The Comptroller asserted jurisdiction under section 8(e)(1).[21] After a hearing and certification to the Board of Governors of

12. Subsection (j) provides a fine up to $1 million and imprisonment (up to) 5 years for officials who, without prior written approval from the appropriate agency, knowingly participate in the affairs of any insured depository institution after they are suspended or removed from their position.

13. 609 F. Supp. 128 (E.D. Tenn. 1985).

14. *Id.*

15. *Id.* at 129.

16. *Id.* at 129.

17. *Id.* at 129-30.

18. *Id.* at 130.

19. 868 F.2d 1308 (D.C. Cir. 1989).

20. *Id.* at 1309.

21. The Comptroller asserted jurisdiction under what was then 12 U.S.C. § 1818(e)(2) (1989). *See* Stoddard, 868 F.2d at 1309. Prior to FIRREA, 12 U.S.C. § 1818(e) contained two subsections granting removal authority to the banking agencies under differing conditions. These subsections have now been replaced by 12 U.S.C. § 1818(e)(1) (1989).

the Federal Reserve (Fed), the order to remove Stoddard was finally issued three-and-a-half years after his resignation.[22]

The circuit court's analysis of Stoddard's challenge to the removal order was surprisingly straightforward. The court was cognizant that the Fed's sole purpose in "removing" Stoddard after he had resigned was to expose him to the provisions of 12 U.S.C. § 1818(j). That section, as it then read, would have provided criminal sanctions should Stoddard have later become involved with the same bank.[23] Indeed, the Fed argued for the removal by emphasizing that without agency access to 12 U.S.C. § 1818(j), bank officials could escape the sanctions that Congress intended for them by effecting last-second resignations. However, the *Stoddard* court rejected the Fed's effort to make subsection (e) applicable to former officials, opining that "One cannot remove what isn't there."[24] Accordingly, the court vacated the Fed's order of removal.[25]

Congress took dead aim at the *Stoddard* decision in drafting FIRREA. FIRREA provides in subsection (i)[26] that an official's resignation has no effect on the agencies' authority to issue a notice of removal, as long as the notice was served within six years of the resignation. FIRREA also makes this rule retroactive, covering resignations that occurred long before enactment of FIRREA.[27] In explaining its authority to make such a provision retroactive, the Joint Conference Committee explained that, "This section does not create a new offense; it is procedural in nature, and can therefore be applied retroactively to yet undiscovered misconduct and to currently pending supervisory matters that have been stayed awaiting Congressional action."[28] The House Committee on Banking, Finance and Urban Affairs justified the retroactivity provision by proposing that the new subsection (i)(3) was intended to "clarify" the "ambiguity" addressed by *Stoddard*, and left no doubt that the new section was intended to cure the problem of resignations which were meant "to thwart the initiation of an agency enforcement action."[29] Accordingly, if the courts agree that this change in the statute was merely "procedural," *Stoddard* is overruled and officials who resigned years before FIRREA's enactment are subject to its removal provisions. Indeed, the Second Circuit has recently refused to follow *Stoddard*. Instead, that court relied on subsection (i) and refused to enjoin removal proceedings against two former directors of a bank that had been liquidated by the Comptroller of the Currency.[30]

II. SUSPENSION AND REMOVAL PRACTICE

After serving the targeted official with a "notice of removal," which must contain a statement of facts constituting the grounds asserted,[31] an agency hearing

22. Stoddard, 868 F.2d at 1310.
23. *Id.* at 1311. Had FIRREA been in effect, 12 U.S.C. § 1818(j) would have provided criminal sanctions if Stoddard subsequently participated anywhere in the insured depository industry, not merely in the same bank. *See infra*, part V.
24. Stoddard, 868 F.2d at 1310.
25. *Id.* at 1312.
26. 12 U.S.C. § 1818(i)(3) (1989).
27. *Id.*
28. H. Conf. R. No. 101-222, 101st Cong., 1st Sess. (1989), *reprinted in* 1989 U.S.C.C.A.N. 432. The reference to Congressional inaction is undoubtedly related to the funding problems experienced by federal regulators during the period when FHLBB and FSLIC were phased out.
29. H.R. Rep. No. 54(I), 101st Cong., 1st Sess. (1989), *reprinted in* 1989 U.S.C.C.A.N. 86.
30. *See* Greenberg v. Comptroller of the Currency, 938 F.2d 8 (2nd Cir. 1991).
31. *See* 12 U.S.C. § 1818(e)(4) (1989), (formerly) 12 U.S.C. § 1818(e)(5) (1986).

must be scheduled within 60 days.[32] If the action is one brought by the Comptroller of the Currency, the findings of the ALJ must be certified to the Fed, which decides whether the removal order shall issue.[33]

Upon issuance of a notice of removal, the agency is empowered, prior to any hearing or response from the targeted official, to immediately suspend the official if the agency determines that suspension is necessary for the protection of the institution or its depositors.[34] Once the suspension order is issued, the targeted official has only 10 days in which to apply to the district court for a stay of the order.[35] The suspension commences upon service of the suspension order and continues until lifted by court order or until after the banking agency makes its final decision.[36]

The courts' jurisdiction with regard to suspension and removal under 12 U.S.C. § 1818(e) is determined by two statutory subsections. Subsection (h) provides for judicial review of final removal orders solely in the Circuit Courts of Appeals. Subsection (i) withdraws jurisdiction from the courts by providing that no court has jurisdiction to "affect by injunction or otherwise the issuance or enforcement of any notice or order under [12 U.S.C. § 1818] or to review, modify, suspend, terminate, or set aside any such notice or order."[37] However, the proper application of both of these subsections is somewhat confused after the district court decision in *Somerfield v. Federal Deposit Insurance Corporation*.[38] In disposing of Somerfield's petition to enjoin his notice of removal for lack of FDIC jurisdiction, the court made two questionable statements regarding its own jurisdiction. The court asserted, without explanation, that it had no jurisdiction to enjoin the removal procedure in light of subsection (i).[39] While this was technically correct, given the outstanding issue of fact concerning Somerfield's resignation date, the implication that district courts are barred from determining whether a banking agency has exceeded its statutory authority by issuing a notice of removal appears to conflict with prior decisions under subsection (i).[40]

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32. *Id.*

33. *Id.*

34. 12 U.S.C. § 1818(e)(3) (1989), (formerly) 12 U.S.C. § 1818(e)(4) (1986).

35. 12 U.S.C. § 1818(f) (1989).

36. 12 U.S.C. § 1818(e)(3)(B) (1989). Jurisdiction for the stay hearing is in the District Court of the District of Columbia or in the federal district court in the district where the institution's home office is located. Appeal of the agencies' final orders is to the Court of Appeals of the Federal District or to the court of appeals where the subject's home office is located, and must be made within 30 days of service of the order. 12 U.S.C. § 1818(h)(2) (1989).

37. 12 U.S.C. § 1818(i) (1989).

38. 609 F. Supp. 128. For explanation of the facts of this case, *see supra* text accompanying notes 10-19.

39. *Id.* at 129. 12 U.S.C. § 1818(i) (1989) states in pertinent part:

> [E]xcept as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

Id.

40. *See* Manges v. Camp, 474 F.2d 97, 99 (5th Cir. 1973) (holding that 12 U.S.C. § 1818(i) did not foreclose the district court from hearing challenge to action of the Comptroller of Currency taken under 12 U.S.C. § 1818(g)(1), in barring majority stockholder who was convicted of crime from participation in bank, on the ground that the action exceeded the Comptroller's statutory authority); *See also* Groos Nat'l Bank v. Comptroller of Currency, 573 F.2d 889, 895 (5th Cir. 1978); First Nat'l Bank of Scotia v. United States, 530 F. Supp. 162, 169 (D.D.C. 1982); and Mid America Bancorporation v. Board of Governors, 523 F. Supp. 568, 575 (D. Minn. 1980).

Nothing in FISA or FIRREA expressly forbids the district courts from entertaining challenges to agency actions on the ground that the limited agency has exceeded its statutory authority. Subsection (i) is a withdrawal provision which forbids judicial interference only with actions brought "under the statute." Certainly, the district court should hear a challenge to an agency action if the challenger alleges that the action is outside the agency's statutory authority. In addition, it would be a strained reading of subsection (i) to hold that Congress *implicitly* banned prior judicial review of the agencies' authority to act at the same time it explicitly withdrew only the jurisdiction to review lawful agency procedures.

However, the Supreme Court has taken the position that subsection (i) withdraws all jurisdiction from the district courts "to review and enjoin the [agencies'] ongoing administrative proceedings."[41] Accordingly, challenges to agency jurisdiction during removal or suspension proceedings are now foreclosed, other than, perhaps, in stay applications under 12 U.S.C. § 1818(f).

Since suspension orders are issued *ex parte* in the absence of hearings, and because a suspension order can be expected to be extremely disruptive to the institution and the official, the courts should be somewhat circumspect in continuing the effectiveness of suspension orders in the face of stay applications. Such reticence was displayed in *[Anonymous] v. Federal Deposit Insurance Corporation* ("*Anonymous I*").[42] In that case, FDIC issued a notice of removal and immediate suspension to a targeted official, based upon the results of a bank examination. This examination revealed a loan made in violation of state banking law, as well as other questionable transactions.[43] In granting the targeted official a stay of the suspension, pending completion of an FDIC removal procedure, the district court made several interesting observations which led it to strictly construe the agency's suspension authority.

In reviewing the statutory prerequisites for suspension orders, the court noted the regrettably sparse guidance provided by Congress to the agencies. FISA merely required the agency to "deem it necessary for the protection of the bank or the interest of its depositors" for the suspension order to be issued.[44] The *Anonymous I* court considered the suspension order a "constraint on individual liberty" and demanded that the agency undertake the requisite protection.[45] The court bemoaned the statute's lack of a detailed list of factors for the agencies to consider prior to issuing a suspension order and the absence of FDIC regulations or guidelines to aid its employees in determining when suspensions were warranted.[46] Accordingly, the court felt that the FDIC was without a sufficient

41. Board of Governors of the Fed. Reserve Sys. v. MCorp Financial, Inc., 60 U.S.L.W. 4005 (U.S. Dec. 3, 1991) (No. 90-913, 90-914).

42. 617 F. Supp. 509 (D.D.C. 1985).

43. *Id.* at 514.

44. *See* 12 U.S.C. § 1818(e)(4) (1989) as it existed prior to FIRREA. The current version is no more descriptive, requiring the agency to "determine[] that such action is necessary for the protection of the depository institution or the interests of the depository institution's depositors." 12 U.S.C. § 1818(e)(3)(A)(i) (1989).

45. Anonymous I, 617 F. Supp. at 513.

46. *Id.* FDIC has since promulgated regulations regarding suspensions. *See, e.g.*, 12 C.F.R. 308.73. However, these regulations give no guidance on interpreting the statutory grounds for suspension.

explanation of how or why it deemed this official was deserving of a suspension, raising serious due process concerns.[47]

In reviewing the target official's stay application, the *Anonymous I* court also found that the potential damage to the targeted official's reputation was sufficient to satisfy the "irreparable harm" requirement for injunctive relief. Although the court observed that an injury to one's reputation is generally not sufficient to establish irreparable harm, the court concluded that Congress had granted the right to apply for a stay of suspensions as a recognition of the injury to career inherent in the suspension procedure. To find additional support for issuing the stay, the court referred to the presumption that removal hearings be held in private[48] under (then) 12 U.S.C. § 1818(h)(1) as evidence that Congress recognized the potential damage brought on by these procedures and intended to provide protection to the officials' reputations.

The *Anonymous I* court turned finally to the public interest concerns raised by allowing the official to continue in office pending the removal process. In holding that FDIC made an insufficient showing of danger to the public to warrant an immediate suspension, the court stated that the FDIC had apparently not even weighed the potential costs and benefits of permitting the officer to continue his involvement pending the removal process. Accordingly, the court entered a stay of the suspension order.

Given the broad discretion granted to the banking agencies by FISA and FIRREA, targeted officials can be expected to utilize stay applications to disrupt the orderly agency suspension and removal procedures. One approach will be to petition the district courts for relief on grounds that the agencies have exceeded their statutory authority or have failed to promulgate adequate regulations to implement the statute. The interventionist language in *Anonymous I* will be helpful to targeted officials in justifying disruption of the agency suspension and removal process on these grounds. In addition, as discussed *infra*, in Part IV, many of FIRREA's suspension and removal provisions appear to be fertile ground for constitutional challenges. Indeed, Congress' attempt to permit the banking agencies to determine the fate of bank officials largely without judicial interference may be doomed by Congress' apparent overreaching in assigning under-defined remedial powers to these agencies.

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47. *See* Anonymous I, 617 F. Supp at 513-14. By contrast, the FIRREA House Committee expressed no concern for "individual liberty" or due process in facilitating the agencies' ability to remove officials in the absence of significant losses to institutions. The committee expressed its opinion that "There is no constitutional or other right for an individual to remain in the financial services industry. . ." seemingly reviving the discredited "right versus privilege" analysis of government licensing. *See* FIRREA Report at 468, *reprinted in* 1989 U.S.C.C.A.N. at 264.

48. This privacy concern was expressed in the FISA Report, which noted that hearings were to be private unless both the agency *and the individual* agree that it should be public. FISA Report at 3539. FIRREA maintains the presumption of private hearings. 12 U.S.C. § 1818(h)(1) (1989). However, FIRREA has altered the existing scheme which protected targeted officials from publicity by providing for immediate publication of all final orders. 12 U.S.C. § 1818(u)(1) (1989). The FIRREA House Report states that this provision was included due to "excessive secrecy" in agency supervisory actions. The committee observed that "such secrecy does little to deter misconduct, but does serve to ultimately worsen the problems of financial institutions." FIRREA Report 470, *reprinted in* 1989 U.S.C.C.A.N. at 266.

III. REMOVAL PREREQUISITES

Once the agency has selected a target official who is subject to its removal authority, it is required to make three independent determinations prior to issuing a removal notice.

A. Improper Conduct

As a prerequisite to issuing a notice of removal the agency must determine that the official has undertaken some improper conduct. This improper conduct must take one of three forms:

(1) violating a law, regulation, final cease-and-desist order, or written agreement between the institution and the FDIC; or
(2) engaging in an unsafe or unsound practice in connection with *any* insured depository institution; or
(3) committing a breach of fiduciary duty.[49]

1. Violations of Law or Regulation

With respect to requirement (1) *supra*, there has been little judicial gloss. A challenge may arise concerning the validity of an ALJ's determination that a *criminal* statute has been violated, absent a conviction by an Article III court. Under the procedures outlined in 12 U.S.C. § 1818(e), the target official may be subjected to an administrative hearing, without the constitutional protections normally afforded to a criminal defendant, to determine whether the target has violated a criminal statute.[50] Although there is no reported decision addressing this issue, one circuit court has recently foregone an opportunity to address the concerns raised by this grant of authority to the agencies. *Van Dyke v. Board of Governors of the Federal Reserve System*.[51] In that case the ALJ had found that Van Dyke, an officer and director of the Toy Bank, had been involved in what the ALJ termed a "check kiting" scheme.[52] The ALJ determined that Van Dyke's involvement in the scheme was a violation of 18 U.S.C. § 1344 (Supp.

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49. *See* 12 U.S.C. § 1818(e)(1)(A) (1989).

50. While it may not be desirable, from the point of view of the agency or the official, to have a criminal trial as a prerequisite to removing a bank official, the reliance on an ALJ's findings of criminal misbehavior is of concern for at least two reasons.

First, the undeniable stigma attached to having a banker's conduct declared criminal requires that some constitutional safeguards be imposed at these hearings. *See* In re Winship, 397 U.S. 358, 363-64 (1970)(Court holding that the Due Process Clause required a heightened standard of proof as defendant would be stigmatized by an adverse decision creating a criminal record). Perhaps increasing the burden of proof for such a determination from a preponderance of the evidence to at least "clear and convincing" would provide an adequate safeguard. *See* Addington v. Texas, 441 U.S. 418, 423-24 (1979) (Court approving the use of a clear and convincing standard in civil suit where reputational interests were in particular jeopardy).

Second, the ALJ's finding of criminal misbehavior can itself lead, at least indirectly, to extremely stiff criminal penalties under 12 U.S.C. § 1818(j). In any event, finding criminal liability should rarely be necessary for removal. As an alternative to showing the criminal violation, the agency may show that the official breached a fiduciary duty or engaged in an unsafe or unsound practice in connection with an insured depository institution. Given these alternatives, which could often be found upon review of the same allegedly criminal conduct, there appears to be little justification for permitting the ALJ's to determine criminal guilt.

51. 876 F.2d 1377 (8th Cir. 1989).

52. *Id.* at 1378.

V 1987), thus satisfying the improper conduct prerequisite for removal.[53] As the circuit court accepted without discussion the ALJ's determination that Van Dyke had violated the statute, it is clear that the Eighth Circuit was not troubled by a determination of criminal guilt being made outside of the Article III courts and without the requisite constitutional protections. It does appear, however that the ALJ was sensitive to this issue. The *Van Dyke* opinion hints that the ALJ's determination may have been subject to a standard of proof greater than a mere preponderance of the evidence. The ALJ's holding was that Van Dyke's conduct "*clearly* fit within the prescription of [section] 1344."[54] Perhaps the ALJ used at least a "clear and convincing" standard of proof in finding the violation and this may have been sufficient to overcome constitutional concerns.

From the legislative history of FISA, it appears that even the most technical and minor regulatory infractions will suffice to satisfy the improper conduct element. The Senate Committee opined that limiting the predicate violations to those involving "personal dishonesty" sufficiently protected banking officials from abuses of agency power.[55] Therefore, the magnitude of the violation was not meant to be a meaningful aspect of the "improper conduct" analysis. However, under FISA there was arguably no provision for a lifetime industry ban.[56] Now that the stakes have been raised by FIRREA, it is likely that courts will resist approving an agencies' lifetime ban punishments for minor, technical infractions.

2. *Engaged or Participated in an Unsafe or Unsound Practice in Connection with Any Insured Depository Institution or Committed a Breach of his Fiduciary Duty.*

It remains unclear what an agency will have to prove if it intends to rely upon its determination that the target official "engaged or participated in any unsafe or unsound practice in connection with any insured depository institution. . . ."[57] or that the official "breached his fiduciary duty." However, the two grounds will tend to merge with respect to any official who has a fiduciary duty to the subject institution and who actively participates in a practice at that institution which is challenged by the agency. The result will be a collapsed analysis of the target's behavior under both alternatives, as it seems likely that any fiduciary participating in an unsafe banking practice will thereby also breach his fiduciary duty. Such a collapsed analysis was performed by the ALJ in *Van Dyke*.

In *Van Dyke* the ALJ was faced with a scheme in which Van Dyke wrote, without sufficient funds on deposit, alternating checks between his checking account at the Toy Bank (which by regulation could not honor an overdraft of director Van Dyke's checking account) and his chronically overdrawn account at a second bank, Norwest.[58] Norwest had consistently honored his overdrafts in

53. *Id.*
54. *Id.* at 1379 (emphasis added).
55. *See* FISA report at 3539.
56. *See infra* part IV.
57. Indeed, the Senate committee considering FISA candidly admitted that "'Unsafe' and 'unsound' have no definite or fixed meaning." FISA report, at 3539.
58. Van Dyke, 876 F.2d at 1378.

the past and Van Dyke's Toy Bank account was kept current through Norwest's continued payment of Van Dyke's overdrafts.[59] The purpose of Van Dyke's scheme was to temporarily forestall Norwest from collecting on the overdrafts until Van Dyke could arrange a loan with a third bank.

The ALJ found that Van Dyke's "check kiting" practice was an unsafe and unsound banking practice *in addition* to a breach of his fiduciary duty to the Toy Bank.[60] These findings were affirmed by the Fed and were not challenged by Van Dyke on appeal.[61]

Van Dyke's collapsed analysis of an official's "participation" in unsafe or unsound practices *and* his breach of fiduciary duty is compelled, it would appear, unless a fiduciary is charged with a culpable *omission* during the course of his oversight function, thereby possibly precluding a finding of "participation." It is also quite possible, however, that a court would deem negligent oversight to be an unsafe or unsound practice, reviving the collapsed analysis.

A negligent oversight situation where the collapsed analysis was not used was reported in *Brickner v. Federal Deposit Insurance Corporation.*[62] In that case, the FDIC found that two directors had breached their fiduciary duties by failing to control the conduct of the bank's cashier. The cashier had made several large, unauthorized extensions of credit to a particular bank customer by failing to post debits to the customer's account. In addition, the cashier repeatedly extended credit to this customer by allowing check overdrafts and by holding the customer's unpaid items in the Bank's correspondent account.[63] The bank president discovered these practices and asked the cashier to cease these activities, but the cashier persisted.[64] Afterward, the two directors discovered that the cashier persisted in these unsafe practices, but they failed to ensure that the practices ceased.[65] The customer eventually defaulted on $1.2 million worth of credit extended by the cashier.[66]

In reviewing the FDIC's determination that the two directors had breached their fiduciary duties, the court stated that such an inquiry was a "mixed question of fact and law."[67] This "mixed question" approach, of course, would grant an appellate court greater latitude to review an ALJ's determinations than if the determinations were considered pure issues of fact. However, the *Brickner* court found no opportunity to define the appropriate scope of review of the ALJ's findings, as the court determined that it would find the two directors' conduct a breach of fiduciary duty even if reviewing *de novo.*[68] Accordingly, the agencies and the industry were left without guidance as to the proper scope of review for such a determination.

Brickner's sole reliance upon finding a breach of fiduciary duty in satisfying the improper conduct requirement illustrates that courts need not perform a

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59. *Id.*
60. *Id.* at 1378-79. (emphasis added)
61. *Id.* at 1379.
62. 747 F.2d 1198 (8th Cir. 1984).
63. *Id.* at 1200.
64. *Id.*
65. *Id.*
66. *Id.*
67. *Id.* at 1201.
68. *Id.* at 1202.

collapsed analysis of "breach of fiduciary duty" and "participation in an unsafe or unsound banking practice" when reviewing the conduct of fiduciaries. Indeed, *Brickner* illustrates that the separate analysis makes it easier for an agency to effect removal of a fiduciary. It is not certain that the two directors could have been found to have "participated" in an "unsafe or unsound practice" by failing to stop the cashier from extending credit. Were it not for the statute's separate breach of fiduciary duty alternative the two directors may have escaped their fate.

B. Negative Consequences

Having made determinations that overcome the initial hurdles, the agency must find that the improper conduct resulted in certain negative consequences. Here the agency must find one of the following three negative consequences of the improper conduct:

(1) the affected institution has suffered or will probably suffer damage;
(2) the interest of the depositors has been or could be prejudiced; or
(3) the officer or director received a benefit as a result of the challenged conduct.[69]

There has been little helpful discussion in the cases as to how these three requirements may be satisfied. From the statutory language one suspects that proving actual damage to the institution or actual prejudice to the depositors will raise no unusual fact-finding issues. The more difficult issues will arise in devising a standard for finding "probable" damage to the institution, given that the probable damage need not be financial in nature.[70] Whether finding a practice that *might* cause damage will suffice, or whether finding a practice *probably would* cause damage will be required, cannot be said at this time. Indeed, the meaning of those alternatives, even if the courts eventually settled upon one, is unclear. Similar issues present themselves in requiring proof that depositors' interests "could be prejudiced." However, since it is undoubtedly easier to find potential damage to the institution than to the (substantially insured) depositors, the depositor alternative will rarely be useful to the agencies.

Congress has given guidance in FIRREA on how much "damage" or "prejudice" must be demonstrated to clear the "negative consequences" hurdle to removal. Under FISA, the agency was required to show that the institution had or would suffer *substantial* damages before a negative consequence would be established.[71] In the alternative, prior to FIRREA, the agency was required to show that the depositors had or would be *seriously* prejudiced by reason of the challenged practices.[72] In FIRREA, both of these qualifiers were dropped.[73] Accordingly, a much smaller quantum of damage to the institution or prejudice to the depositors, real or merely threatened, will now suffice. By way of explanation, the House Committee reported that FIRREA "would allow an agency to proceed with removal or prohibition action[s], where warranted, without

69. 12 U.S.C. § 1818(e)(1)(B) (1989).
70. *See* 12 U.S.C. § 1818(e)(1)(B)(i) (1989).
71. *See* (former) 12 U.S.C. § 1818(e)(1) (1986).
72. *Id.*
73. *See* 12 U.S.C. § 1818(e)(1)(B)(ii).

having to quantify losses to the institution or the degree of prejudice to the depositors."[74]

The inclusion of the third alternative negative consequence requirement, "benefit to the official," is interesting, as it can eliminate the need to prove that the challenged conduct produced any negative effect on the insured depository industry. In addition, FIRREA widened the reach of this third alternative. Under FISA, the third alternative negative consequence could only be satisfied if the official had received a *financial* benefit from his misdeeds.[75] FIRREA eliminated that qualifier and any benefit will now suffice.[76]

One probable result of FIRREA's inclusion of this "benefit to the official" means of finding a negative consequence is to foreclose the "no harm, no foul" defense, except in the rare situation where there was an unsafe practice which did not threaten the institution or depositors and did not benefit the official. However, it is extremely doubtful that such a situation would generate sufficient agency interest to warrant a removal action.

In trying to determine the current viability of the "no harm, no foul" defense, the court's discussion of the official's "no harm no foul" defenses in *Van Dyke, supra,* is informative. Van Dyke's first such argument attempted to limit the inquiry to the scheme's effect upon his own institution. Van Dyke argued that any consideration of his personal dishonesty, for the purposes of removal from the Toy Bank, must focus entirely on that institution.[77] Van Dyke claimed that the Toy Bank was not harmed and was never at risk because the second bank, Norwest, had always honored his overdrafts. From this premise he concluded that any risk of loss was on Norwest and his removal from the Toy Bank was unwarranted.[78]

The court gave this argument little consideration, admonishing that "to suggest that we focus exclusively on Van Dyke's dealings with Norwest in evaluating his conduct as a Toy Bank officer and director ignores the inherent multiple-bank characteristics of a check-kiting scheme."[79] While this statement would appear to leave the door open for excusing a scheme in which all of the conduct was unrelated to the official's own bank, there is nothing in the tone of *Van Dyke* to suggest to a hopeful targeted official that the Eighth Circuit would find that distinction persuasive.

Van Dyke's second, seemingly more persuasive attempt at a "no harm, no foul" defense arose from the fact that apparently neither bank lost any money in the transactions. However, the court's reaction to the defense that no bank was harmed was no more favorable than its reaction to Van Dyke's first argument, explaining that "we think it unrealistic for Van Dyke to suggest the Board is powerless to respond to an officer's manipulative, self-dealing activity until actual harm to the Bank occurs."[80]

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74. *See supra* note 28, at § 903.
75. *See* (former) 12 U.S.C. § 1818(e)(1) (1986).
76. The negative consequence requirement may now be satisfied if the official "has received financial gain *or other benefit* by reason of such violation, practice, or breach;" 12 U.S.C. § 1818(e)(1)(B)(iii) (1989) (emphasis added).
77. Van Dyke v. Board of Governors of the Fed. Reserve Sys., 876 F.2d 1377, 1380 (8th Cir. 1989).
78. *Id.*
79. *Id.*
80. *Id.*

The District Court in *Anonymous I, supra* took a similar dim view of the "no harm, no foul" defense. There the targeted official was accused of making questionable loans. He defended against the allegation that the loans were unsound by offering to prove that the loans were being paid off, with interest.[81] In reacting to the official's defense based on subsequent repayment, the court noted that "subsequent partial repayment of an insufficiently secured or collateralized loan does not vitiate the initial determination that the loan was imprudent when made and that the bank has therefore suffered a significant injury."[82]

As can be seen, the "no harm, no foul" defense was not powerful under FISA. Under FIRREA, it can be expected to fare no better.

C. Scienter

Having satisfied the aforementioned prerequisites to removal, the agency must determine that the challenged conduct involved the requisite scienter. Satisfying FIRREA's scienter requirement requires that the agency determine that the official's actions demonstrate either "personal dishonesty" or "a willful or continuing disregard . . . for the safety or soundness of such insured depository institution or business institution."[83] Given the existence of judicially approved interpretations of these key statutory phrases in *Van Dyke*, ALJ's have reliable standards against which they can measure the scienter of officers' conduct.

1. Personal Dishonesty

The detailed discussion of "personal dishonesty" in *Van Dyke* gives substantial guidance on the interpretation that term is likely to receive at the agency and the appeals court levels. In viewing Van Dyke's check - kiting scheme, the ALJ determined that the relevant examples of Van Dyke's conduct did "not demonstrate personal dishonesty nor [did] they seem to be of such a nature as to involve a disregard for the safety or soundness of the Bank."[84] In determining that Van Dyke's conduct did not demonstrate personal dishonesty or the requisite statutory disregard, the ALJ "equated personal dishonesty with an intent to gain at the expense of others."[85] Accordingly, the ALJ did not recommend removal.

In its review of the ALJ's decision, the Fed disagreed with the ALJ's standard for scienter. The Fed then articulated its own standard for finding personal dishonesty, much of which was upheld by the circuit court. In considering the proper boundaries of actionable "personal dishonesty," the *Van Dyke* court deferred to the Fed's reasonable position that personal dishonesty need not amount to civil fraud.[86] However, the circuit court then upheld the Fed's expansive standard for determining whether conduct demonstrates personal dishonesty. The court approved the Fed's position that such conduct "may include that which illustrates a 'disposition to lie, cheat[,] or defraud; untrustworthiness; lack of integrity[;] . . . misrepresentation of facts and deliberate deception by pretense and stealth; . . . [or] want of fairness and [straightforwardness]."[87]

81. [Anonymous] v. Federal Deposit Ins. Corp., 617 F. Supp. 509, 515 (D.D.C. 1985) ("Anonymous I").
82. *Id.*
83. 12 U.S.C. § 1818(e)(1)(C) (1989).
84. Van Dyke, 876 F.2d at 1379.
85. *Id.*
86. *Id.*
87. *Id.*

This astoundingly broad checklist will provide ALJ's with a "standard" that will make finding personal dishonesty possible under the widest variety of circumstances. The expansive phrase "disposition to" allows the ALJ to focus on more than just the examples of conduct in evidence. It permits (compels?) a psychological analysis of the target official to determine the propensity of that official to undertake dishonest actions, given that he undertook the conduct in evidence. If this analysis fails to reveal sufficient propensity to be dishonest in the future, perhaps due to deft expert testimony by the targeted official's psychological expert, the agency may still find plenty of fertile ground in the *Van Dyke* standard. According to *Van Dyke*, the ALJ may find that the conduct was personally dishonest if the conduct demonstrates a want of fairness or straightforwardness. One struggles to identify a legal standard more susceptible to due process, void-for-vagueness objections.

As can be seen, even before FIRREA the "personal dishonesty" alternative to finding scienter was a complete abrogation of any traditional culpability requirement. This alternative means of finding scienter does not require a determination of willful, knowing, or even negligent behavior to justify removal. Honest business practices which are found to be unfair or which lack "straightforwardness" will suffice to establish the required scienter. Accordingly, the scienter prerequisite to removal will present only a minor barrier to removal efforts of the banking agencies, given this expansive view of "personal dishonesty."

2. *Willful or Continuing Disregard*

In affirming the Fed's determination that Van Dyke had committed "willful disregard for the safety or soundness of the [Toy] Bank," the Eighth Circuit also approved the Fed's guidelines for defining that key term.[88] The Fed guidelines required consideration of whether Van Dyke's conduct "potentially exposed the Bank to an abnormal risk of loss or harm contrary to prudent banking practices."[89] This definition of "willful or continuing disregard" directs ALJ's to focus on the disregard for the *potential* for harm as a result of the questioned banking practices, but gives little guidance on the culpability standard to be applied.

Guidance on the necessary mental state that will support a finding of "willful and continuing disregard for the safety or soundness of the bank" may be gleaned from the Eighth Circuit's decision in *Brickner*.[90]

In *Brickner*, the two targeted directors defended against removal by arguing that even if they had breached their fiduciary duty, that alone did not warrant removal. The directors asserted that to justify removal under the statute, there must be a finding that they *willfully* did something to injure that bank. In response the court observed that the FDIC need not show both willful *and* continuing disregard to justify removal.[91] Additionally, the court concluded that although a showing of continuing disregard requires some degree of knowledge,

88. *Id.* at 1380.
89. *Id.*
90. For a discussion of the facts of *Brickner*, *see supra* text accompanying notes 62-68.
91. Brickner v. Federal Deposit Ins. Corp., 747 F.2d 1198, 1202-03 (8th Cir. 1984).

it requires a lower degree of intent than "willful disregard." Using this approach, the court concluded that the directors' knowledge for a period of months that the cashier was engaging in unsafe and unsound banking practices was sufficient to show continuing disregard for the safety and soundness of the bank. Accordingly, *Brickner*, if followed, would lower the culpability that the agency needs to prove for multiple related instances of forbidden conduct from "willful" to "knowing." Since few removal actions will involve a single, isolated infraction, *Brickner* would eliminate the "willful" culpability standard for most removal actions.

It would appear that the ease in finding culpability under *Brickner*, when combined with the checklist approach to finding "personal dishonesty" under *Van Dyke*, creates a scienter standard which fails to focus on evilmindedness. Accordingly, the scienter requirement will not be a significant restraint on the agencies' apparent ability to target honest but risky conduct on the part of bank officials. In light of these two cases and the FIRREA sanctions, bank officials will be understandably reluctant to undertake activities not already recognized as "prudent banking practices," given the potentially career-ending consequences of undertaking risky banking activities.

IV. THE EXTENT OF THE REMOVAL POWER

After a banking agency makes the determinations described in Part III, it may serve upon the targeted official a written notice of the agency's intention to remove him from office and/or to prohibit him from further participation in "any insured depository institution."[92] Does this mean that all suspended or removed officials are automatically subject to an industrywide ban, or must the agency order removal on a bank-by-bank basis? This issue, in the case of removal, has not been judicially addressed. However, in a pre-FIRREA case, *[Anonymous] v. Federal Deposit Insurance Corporation*,[93] ("*Anonymous II*"), there was considerable discussion of the meaning of "any insured depository institution" within in the context of a 12 U.S.C. § 1818(e)(1) & (2) suspension order.[94] In *Anonymous II*, the targeted official held positions at several banks. Upon examination of one of those banks, FDIC served notice on the target official that it was initiating proceedings to not only remove him from his office at the examined bank, but to bar him from participation in all federally insured banks by authority of 12 U.S.C. § 1818(e)(1).[95] In addition, the official was suspended from his office and prohibited from further participation in all federally insured depository institutions pending resolution of the removal proceedings.[96]

In reviewing FDIC's authority to issue this blanket suspension, the court noted that Congress had drawn a distinction in 12 U.S.C. § 1818(e)(1) & (2) (as those subsections existed at that time) between misconduct at the targeted official's own institution and misconduct with respect to other institutions or businesses.

92. 12 U.S.C. § 1818(e)(1) (1989).
93. 619 F. Supp. 866 (D.D.C. 1985).
94. After FIRREA, the suspension provisions are contained in 12 U.S.C. § 1818(e)(3) (1982).
95. *See* Anonymous II, 619 F. Supp. at 867. The Court referred to the then-existing 12 U.S.C. § 1818(e)(1) & (2) (1982); *amended* 12 U.S.C. § 1818 (e)(1), (2)(b) (1989).
96. *Id.* at 867.

The court noted that when the disputed misconduct concerned institutions where the targeted official was not employed, an additional finding of either "personal dishonesty," or "willful or continuing disregard for a banks' safety and soundness," was required before the removal notice may be issued.[97] Noting these more stringent requirements for measuring conduct occurring outside the targeted official's institution, the *Anonymous II* court concluded that Congress could not have intended that officials could be suspended from institutions with whom they had no contact. The court stated that FDIC had the authority to suspend the target from an unlimited number of banks, but had to do so on a bank-by-bank, individualized basis.[98] In dictum, the court also opined that the bank-by-bank requirement applied to removal as well as suspension.[99]

The *Anonymous II* position barring blanket suspensions and removals appears to be in great jeopardy after FIRREA, despite FIRREA's reaffirmation of the same "any insured institution" language. First, FIRREA no longer distinguishes between conduct at the targeted official's bank and conduct directed toward other institutions. In addition, under the language of 12 U.S.C. § 1818(e)(7), entitled "Industrywide prohibition," officials subject to suspension or removal orders appear to be automatically subject to a ban from participation in to the entire insured depository system,[100] absent an express written exception from the appropriate agency.[101] However, the statute fails to state specifically whether the suspension or removal order must identify the individual forbidden institutions or whether the industrywide ban is assumed, absent an articulated exception.[102] Accordingly, the *Anonymous II* requirement of an institution-by-institution order may still hold some life.

V. PENALTIES FOR VIOLATION OF SUSPENSION OR REMOVAL ORDERS

Much of the attractiveness of the removal procedure to the agencies emanates from the subsequent availability of the criminal provisions of subsection (j). This subsection provides stiff criminal penalties[103] for any individual subject to an effective removal order who knowingly participates in the business of "any insured depository institution," absent agency permission.[104] This blanket ban permits the agency issuing the order to control or eliminate the official's partic-

97. *Id.* at 870.
98. *Id.* at 872.
99. *Id.*
100. 12 U.S.C. § 1818(e)(7)(A) (1989).
101. 12 U.S.C. § 1818(e)(7)(B) (1989). Indeed, a strict reading of the statute would forbid the official from having discussions with the agencies themselves on any matters other than the removal proceedings. *See* 12 U.S.C. § 1818(e)(7)(d) (1989).
102. Support for the continued existence of a requirement that the agency make an institution-by-institution determination of the scope of a suspension or removal order may be found in 12 U.S.C. § 1818(e)(7)(B). This paragraph provides agencies with the power to grant applications for exceptions to suspension or removal orders which "prohibit[] such party from participating in the conduct of the affairs of *an* insured depository institution." *Id.* (emphasis added). This language can be read by the hopeful official as assuming that the orders would identify the particular institutions affected.
103. *See* 12 U.S.C. § 1818(j) (1989) providing fines up to $1,000,000 in addition to imprisonment of up to 5 years.
104. 12 U.S.C. § 1818(j)(1) (1989).

ipation in the insured banking community indefinitely, and apparently moots the issue presented in Part IV of whether the order itself must designate the scope of the ban.

Before FIRREA was enacted, subsection (j) provided that criminal penalties were applicable to officials who were subject to any effective notice or order "which is an order which has become final" under subsections (e)(4) & (e)(5). These were the FISA subsections authorizing suspensions and removals respectively. FIRREA eliminated this "final order" qualification in subsection (j). Prior to FIRREA, the language of former subsection (e)(4) made it unclear whether participation during a suspension, which may not have been pursuant to a "final order," triggered the penalties of subsection (j). However, subsection (j) now clearly makes it a criminal act to knowingly participate, without prior written approval of the appropriate regulatory agency, in the affairs of any insured depository institution while "an order [is] in effect under subsection (e)[.]" As subsection (e) now specifically authorizes orders for both suspensions and removals, there can no longer be serious doubt that subsection (j) applies equally to officials subject to either suspension or removal orders. Thus, FIRREA has effectively created an automatic blanket suspension, with severe criminal penalties for its breach, through the operation of section 1818(j).

VI. CONCLUSION

To paraphrase an old legal maxim, tough situations make for bad laws. The 101st Congress was faced with a crisis which FISA and other existing legislation appeared inadequate to address. The result was the monster called FIRREA.

The suspension and removal provisions of FIRREA present numerous constitutional questions. For instance, they implicate due process concerns through their depravation of personal liberty to pursue one's occupation in the absence of statutory guidelines or adequate procedural opportunities to respond to charges. Indeed, certain aspects appear to violate the constitutional ban on *ex post facto* laws.[105] FIRREA also authorizes stiff criminal penalties based on findings of criminal violations by administrative law judges, without any provision for the constitutional protections generally available to criminal defendants in an Article III court. In addition, FIRREA creates multi-alternative methods of finding actionable conduct which are so loose that prosecutorial discretion appears to be the only meaningful restraint on mass removal of bank officials. We may imagine a bank officer who resigned four years ago; who committed a minor, technical infraction; whose conduct did not threaten the welfare of any institution; but who received a personal benefit from the infraction; and whose conduct illustrated a want of fairness to another party. Under the existing case law and FIRREA, this official can be banned for life from the insured depository industry.

The repercussions of the suspension and removal provisions of FIRREA are, of course, undetermined at this time. However, these provisions threaten to have the unfortunate effect of stifling innovative methods of improving the condition of insured depository institutions. In attempting to improve the condition of their banks, officials are now unlikely to implement untested, imaginative banking

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105. *See* U.S. CONST. art. I, § 9, cl. 3.

practices or even sure-fire practices that might exploit weaknesses of other financial institutions. These methods, if unsuccessful, may be deemed "unsafe or unsound," or may be determined to illustrate a "want of fairness." Such determinations could lead to a career-ending ban by the banking agencies.

FIRREA's extension of removal powers to accountants and lawyers is also troubling and, perhaps, counterproductive. These professionals (and their insurers) are already reeling from the deluge civil lawsuits brought as a result of their work for distressed financial institutions. The added possibility of permanent blanket bans in addition to these potential liabilities could lead firms with viable alternatives to direct their resources toward clients outside the insured depository industry, or at least away from insured institutions in financial trouble. This would leave troubled insured institutions without access to talented professional assistance at the very time they need it most.

The most probable outcome of the sudden, vast expansion of the suspension and removal powers under FIRREA is that the courts will be called upon to temper the zeal of Congress and the agencies. While this is not the preferred method of implementing national policy, it is a familiar one. How the courts respond will help determine the fate of the insured depository system.